

Decision 84 CS 115 AUG 7 1984**ORIGINAL**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the application of
 Ridgecrest Heights Land and Water
 Company, a California corporation,
 to increase the rate applicable to
 flat rate water service furnished to
 customers in and near the City of
 Ridgecrest, Kern County.

Application 83-08-41
 (Filed August 15, 1983)

O P I N I O NStatement of Facts

Ridgecrest Heights Land and Water Company (Ridgecrest), initially known as the Rocket Town Water Company, was organized in 1949. It was financed by Trans-continental Land and Water Company, a subdivider, to provide public utility water service to certain of the developer's tracts in unincorporated areas west of the then unincorporated community of Ridgecrest in Wells Valley in Kern County. The community came into being when the Navy built an ordnance test station at adjacent China Lake. In 1961 the utility's name was first changed to its present appellation. In 1968 it was purchased by Northern Mojave Land, Inc., a California real estate development organization controlled by Wilbur H. and Mary R. Stark, and transacted its business under the Fictitious Business Name Statute as Ridgecrest Heights Water Company. In 1974 it again became Ridgecrest Heights Land and Water Company, and today is a corporation organized under the laws of the State of California.

Since its inception Ridgecrest has experienced supply and water pressure deficiencies that have resulted in substandard service, especially at higher elevations and during peak demand summer months. The water system, having been constructed initially as a land speculation adjunct in the post-war period with second-hand materials and equipment, undersized, and deficient in almost every

aspect, was antiquated 16 years ago when Stark and his wife acquired it. Since then much work has been put into it and expenditures to improve the system have been made, but most have been frittered away in Rube Goldberg installations, using second-hand or "best buy" materials, usually without professional engineering guidance or assistance (See Decision (D.) 89661 dated November 28, 1978 in Order Instituting Investigation 17 for details). But funds for significant improvements have always been lacking. Staff estimates that rehabilitation to full Commission General Order (G.O.) 103 standards would today require an investment in excess of 5 million dollars. However, absent a very unlikely and very substantial building boom in the area with a large population influx, no one today is going to invest that kind of money in this sprawling, very sparsely built-up, and high desert area.

Mandates to improve service have not been lacking. In various proceedings as far back as 1977 Ridgecrest has been ordered to improve service, employ professional engineering assistance, and formulate plans to correct deficiencies. Pending achievement of some improvement, extension of service to adjacent unserved areas has been prohibited. But no one has suggested where the large investment of funds that would be required to carry out these orders was to come from. And primarily as a consequence of the limited availability of the owner's funds, these various orders largely have been ignored.

Needless to say, Ridgecrest has not been a financial success for its owners. But it has been a source of continued frustration to all involved with it, the customers, the owners, this Commission, the State health authorities, and the courts. Between 1972 and 1980, in a period of escalating costs, severe inflationary pressures, deteriorating service, and problems relating to a refund obligation which arose from an earlier attempt to collect unauthorized connection fees, Ridgecrest was unsuccessful in attempts to obtain rate relief. Several advice letter filings were rejected as deficient. Nonetheless, during the entire period, through the

tenacious efforts of Stark, and his 11th hour but timely advances of interest free funds for operating and maintenance expenses, as well as a Bank of America loan, Stark kept the utility functioning, furnishing water at very low rates to its customers, albeit without meeting G.O. 103 pressure standards, or in volumes sufficient to attain the fire flow minimums required by that standard. Ultimately, in October of 1980 and April of 1983 increases were authorized by the Commission which brought the aggregate monthly water charge for the average Ridgecrest customer to its present \$13.50.

However, it must be noted that these increases served merely to cover those operating expenses deemed reasonable by our staff after a thorough field investigation. They provided rates which produced a minimal rate of return (on a strongly disputed rate base) of 2.6%.

Meanwhile, as a consequence of complaints arising out of the substandard water system, and from a desire to alleviate at least the worst of these problems, in November of 1982 the Commission ordered Ridgecrest to pursue diligently a substantial loan under provisions of the Safe Drinking Water Bond Act (SDWBA - See Water Code Section 13850 et seq.), threatening in the alternative to go into Superior Court under provisions of Public Utilities Code § 855 to have a receiver appointed to assume possession of the system and to operate it (See D.82-11-043 dated November 3, 1982). Concurrently, the California Department of Health Services (Health Services), unsuccessful in its turn in obtaining various improvements it sought to satisfy general health and safety concepts, issued an administrative order requiring Ridgecrest to furnish it a detailed professional engineering report on these improvements. When Ridgecrest failed to comply, Health Services obtained an order from Kern County Superior Court that Ridgecrest, among other matters, submit such a report to Health Services and apply to the State for a SDWBA loan to make the improvements.

Ridgecrest thereupon obtained professional assistance and prepared a rehabilitation plan. This plan, with minor changes, was introduced into evidence during our hearing of Application (A.) 83-01-45, and accepted on the record both by our Hydraulic Branch and by Health Services. By D-83-11-020 dated November 2, 1983, the Commission gave Ridgecrest authorization to borrow up to \$1,498,000 from the State. Since then Ridgecrest has been completing the prerequisite title search and security details for the loan for the Department of Water Resources, so that a Deed of Trust can be recorded and the loan made. The engineers for Ridgecrest and Health Services have been completing detailed plans and specifications. When completed the SDWBA construction will start.

In the interim Ridgecrest has operated on the 2.6% rate of return authorized by our 1983 Resolution W-3086. This produces a return of \$4,176 on Stark's \$162,873 rate base. Stark states that he cannot go on advancing funds to keep the system operating. Accordingly, he has filed this application seeking modification of this 2.6% authorization upward to the same 11.5% which the Commission has generally recognized as appropriate for a "typical" water utility. For the purposes of this application Stark is willing to accept our staff's estimates of revenues, expenses, and rate base as set forth in Resolution W-3086 (the April 6, 1983 increase), but seeks modification of the authorized rate of return. A comparison of resulting revenues required, reflecting the respective 2.6% and the 11.5% rates of return, appears in the first two columns (Present Rate and Requested Modification) of Table A appearing elsewhere in this decision. As the table illustrates, adjusting the rate of return to 11.5% would require an increase in gross revenues of \$19,920 to result in a net revenue of \$18,730. And the present flat rate monthly bill for each of the 1,066 utility customers would increase from \$13.50 to \$15.06.

In September of 1983 a notice was sent to all customers of the utility advising them of this application and of the prospective

modification in rates and the reasons for the modification. Five of the 1,066 customers wrote in response. Three of these complained of continuing low pressure and dirt in their water, objecting to any increase until these problems are resolved. Two others objected to any increase in rates; one stating that while she had never experienced problems, she objected to a rate increase after prior increases in 1980 and early 1983.

Discussion

The Revenue Requirements Division of the Commission has reviewed Ridgecrest's recorded financial statements for the past five years. Their review indicates that the operational losses which have been sustained as of December 31, 1982 have resulted in a negative equity capital. Stark's advancement of interest free funds to meet operational deficits and to make necessary improvements and repairs, regarded as loans by Stark, have been treated as equity capital infusions by the staff. Only the Bank of America loan has been recognized by staff as debt financing. But these facts do point up the fact that Stark is not receiving a fair return on his investment.

Here no issues are being raised regarding these matters although Stark asks modification of the authorized 2.6% rate of return to 11.5%. Stark has agreed to use the Hydraulic Branch's 1983 estimates of operating expenses as set forth in Table A. But he does seek a fair return on his investment. While his past failures to meet all provisions of Commission orders cannot be condoned or excused, we do recognize that the system inherently is a substandard system in an extremely difficult location, and that over the years Stark repeatedly has advanced the funds to shore the system up and he has kept it operating. The most recent example is his 1983 installation of two 200,000-gallon water storage tanks. He is cooperating on the SDWBA loan arrangements and has engaged an engineering firm to work with Health Services to get the most out of the loan proceeds to rehabilitate the worse portions of

TABLE A

ADOPTED SUMMARY OF EARNINGS
(Based on Estimated Year 1983)

RIDGECREST HEIGHTS LAND AND WATER COMPANY

<u>Item</u>	<u>Present Rates*</u>	<u>Requested Modification</u>
<u>Operating Revenue</u>		
Flat Rate	\$172,692	\$192,612
<u>Operating Expenses</u>		
Source of Supply	2,000	2,000
Purchased Power	72,430	72,430
Employee Labor	19,710	19,710
Materials	4,780	4,780
Contract Work	22,250	22,250
Office Salaries	6,000	6,000
Management Salaries	14,280	14,280
Office Supplies & Exp.	3,360	3,360
Insurance	1,310	1,310
General Expense	5,620	5,620
Management Fee		
Total Expenses	151,740	151,740
Depreciation	10,170	10,170
Property Taxes	2,585	2,585
Other Taxes	3,742	3,742
Income Taxes	279	5,645
Total Deductions	168,516	173,882
Net Revenue	4,176	18,730
Rate Base	164,834	164,834
ERTA Adjustments:		
Tax Depreciation	0	0
ITC	1,961	1,961
Adjusted Rate Base	162,873	162,873
Rate of Return	2.6%	11.5%
Monthly Flat Rate Regular Service Charge**	\$13.50	\$15.06

*Source: Resolution W-3086 4/6/83.

**Exclusive of SDWBA surcharge estimated to be \$11.80/mo.

the system. He hired an additional maintenance employee and installed duplicate telephones and an answering service to accommodate customers.

The U.S. Supreme Court in Federal Power Com. v Hope Natural Gas Co. (1984) 320 US 591, stated that while the fixing of just and reasonable rates involves a balancing of the investor and the consumer interests, "From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."

Pursuant to Hope, staff considered at year-end 1983 that a rate of return of 11.5% would be appropriate for a "typical" water utility of the nature of Ridgecrest, but felt that a range of reasonableness existed, depending upon the weight the Commission would wish to give to such matters as service problems. Accordingly, staff recommended that Ridgecrest's authorization be modified to allow a rate of return within the range of 10.50 to 11.50% on its rate base.

Over the past five months since Revenue Requirements made its recommendation we have observed the extent that Stark has cooperated with Water Resources Department in clearing away the bothersome paperwork which leads up to the SDWBA loan funds. The title search details required persistence. We were favorably impressed with Stark's cooperative attitude and actions. He improved relations with Health Services and has given support to his engineer and supervisor in working out the difficult choices that must be made to get the most benefit from and to spread the SDWBA funds over the alternative expensive needs that all present themselves in

competition. His continued independent efforts to improve service in the interim must also be noted. The erection of the two 200,000-gallon water storage tanks to help get past the late summer peak problems that have persistently dogged the system must be recognized. Matters are not perfect, but they have substantially improved.

Five individuals responded to the September 1983 notice of a prospective rate increase; less than 0.5% of the 1,066 customers. The three who related their objections based upon low pressure and dirt in the water presented an objective basis. But their problems cannot be moderated without help from the SDWBA loan. Regardless of Stark's efforts or lack of them, only a real injection of substantial money can moderate those problems. The other two objected to "another" increase, the third in four years. But Stark also has a right to receive fair and just return above and beyond his verified and undeniable expenses. Costs continue upward and there is no cushion to absorb them. The objections to increased rates must give way to Stark's right to receive a just return after so many years of underwriting the losses.

We conclude that no useful purpose would be served by having another hearing at Ridgecrest. At the SDWBA hearing there was ample opportunity to get the feel of the situation prevailing locally. About seventy persons attended that 1983 hearing but only six spoke; not all against a rate increase. Travel funds for hearings are limited. Here there are no expense issues involved, merely the matter of an appropriate rate of return. We have allowed 11.5% generally to typical companies and we see no reason why Stark should be required to underwrite and subsidize this water system further. Particularly with respect to small privately owned water utilities, we believe that an economically healthy company, one where the owner has a respectable proprietorial stake in the operation, and one that produces a fair and adequate rate of return, is the utility which is most capable of and inclined to provide good service on a

continuous basis to its customers. It is our objective to promote development of such utilities. Therefore, in this instance we will authorize modification of the rate of return authorized by Resolution W-3086 of April 6, 1983 to 11.5%. This would serve to increase the monthly flat rate residential service cost from \$13.50 to \$15.06.

Consistent with our established policy defining the responsibility of water utilities to provide acceptable service and establishing penalties for failure to do so, we will make this rate increase subject to refund and cancellation until all SDWBA construction is completed.

Findings of Fact

1. Ridgecrest, a California corporation, is a water public utility under the jurisdiction of this Commission, furnishing public utility domestic water service to a suburban service territory in the City of Ridgecrest, California.

2. Ridgecrest is substantially owned and controlled by Wilbur Stark.

3. By Commission Resolution W-3086 dated April 6, 1983, Ridgecrest was authorized a 2.6% rate of return on an acknowledged rate base of \$162,873.

4. By Commission D.83-11-020 dated November 2, 1983 Ridgecrest was authorized to obtain an SDWBA loan of \$1,498,000 to provide physical plant improvements approximating \$1,150,000 to the Ridgecrest system. This project is approaching realization as final construction plans and specifications are being completed between Ridgecrest's engineers and Health Services.

5. Stark has cooperated in the detailed procedures preliminary to the granting of the SDWBA funds for construction, and in addition at his own expense has continued to make system improvements, including addition of significant water storage capacity.

6. At this time there appears no reason why Ridgecrest should not be authorized the same 11.5% return on rate base as currently is being allowed "typical" small water public utilities.

7. There is no need for a public hearing.

8. The increased rates herein authorized are justified and reasonable, and to the extent the present rates differ, they are or will be for the future unjust and unreasonable.

Conclusions of Law

1. The 2.6% rate of return authorized by Commission Resolution W-3086 should be modified to provide an 11.5% rate of return.

2. The rate increase should be subject to refund and cancellation until the SDWBA improvements are completed.

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, applicant Ridgecrest Heights Land and Water Company (Ridgecrest) is authorized to file the revised rate schedule attached to this order as Appendix A. Such filing shall comply with General Order 96-A. Ridgecrest shall give at least five days' notice, by mail, to its customers, and may thereafter place the revised schedule into effect. The revised schedule shall apply only to service rendered on and after its effective date. The rates will be subject to refund and cancellation until the SDWBA improvements are completed.

This order becomes effective 30 days from today.

Dated August 7, 1984, at San Francisco, California.

Commissioner Priscilla C. Grew,
being necessarily absent, did
not participate

LEONARD M. GRIMES, JR.
President
VICTOR CALVO
DONALD VIAL
WILLIAM T. BAGLEY
Commissioners

I CERTIFY THAT THIS DECISION
WAS APPROVED BY THE ABOVE
COMMISSIONERS

APPENDIX A

Schedule No. 2R

RESIDENTIAL FLAT RATE SERVICE

APPLICABILITY

Applicable to all residential water service furnished on a flat rate basis.

TERRITORY

Tracts Nos. 1466, 1494, 1520, and 1552, and vicinity, located approximately 2 miles southwest of the community of Ridgecrest, Kern County.

RATE

	<u>Per Month</u>	
For each service connection	\$15.06	(I)

SPECIAL CONDITIONS

1. The above residential flat rate charge applies to service connections only on a metered basis.
2. All service not covered by the above classification will be furnished only on a metered basis.
3. A meter may be installed at option of utility or customer for above classification in which event service thereafter will be furnished only on the basis of Schedule No. 1, General Metered Service. When a meter is installed at option of customer, metered service must be continued for at least 12 months before service will again be furnished at flat rates.

(END OF APPENDIX A)

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Dated AUG 7 1984, at San Francisco, California.

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